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June 17, 1998

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JUN 17 1998

**Memorandum of Ex Parte Communication**

Ms. Magalie Salas  
Secretary  
Federal Communications Commission  
1919 M Street, N.W., Room 222  
Washington, D.C. 20554

Dear Ms. Salas:

Re: CC Docket No. 96 - 45, *Universal Service*  
CC Docket No. 97 - 160 - *Forward-Looking Mechanism for Non-Rural LECs*

On Tuesday, June 16, 1998, representatives of Southwestern Bell Telephone Company met with the Honorable Patrick Wood, Chairman of the Texas Public Utility Commission and member of the Federal-State Joint Board on Universal Service regarding the above-listed proceedings. Also in attendance were Ms. Alison Silverstein of the Texas Public Utility Commission and Mr. Rowland Curry of the Texas Public Utility Commission and member of the Universal Service Joint Board Staff. Attending on behalf of SWBT were Mr. Paul Cooper, Mr. Glen Sims, Mr. Jim Lydon.

SWBT's representatives outlined how sufficient and explicit Universal Service funding can be developed in compliance with Section 254 of the 1996 Telecommunications Act. Additionally, the deficiencies of the cost models which have been submitted in the FCC's Universal Service proceedings were described. The attached materials were used during the meeting.

We are submitting the original and one copy of this Memorandum to the Secretary in accordance with Section 1.1206(b)(2) of the Commission's rules.

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Please stamp and return the provided copy to confirm your receipt. Please contact me at (202) 326-8889 should you have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "Jay Byrnes". The signature is fluid and cursive, with a long horizontal flourish extending to the right.

cc (w/o attachments):

Chairman Patrick Wood, III, Alison Silverstein,  
Rowland Curry

**SUFFICIENT AND EXPLICIT UNIVERSAL SERVICE FUNDING CAN BE  
DEVELOPED IN COMPLIANCE WITH SECTION 254 OF THE 1996  
FEDERAL TELECOMMUNICATIONS ACT AS FOLLOWS:**

1. Calculate local exchange costs by LEC by State study area. These costs now provide quality local service and comparable access and service in urban and rural areas as required in Sections 254b(1) and b(3) of the Act and satisfy the definition of Universal Service as discussed in Section 254(c) of the Act. Specifically:
  - a) From book cost data, calculate the annual fully distributed cost of (a) the loop plus; (b) local transport (trunks and tandem switching) plus; (c) the intrastate local usage allocation of the local dial switch.
  - b) The calculation can readily be accomplished by every cost LEC and can be modeled for average schedule LECs. The cost data at the current geographic study area served by each LEC is sufficient to utilize to develop the explicit support requirement for each LEC. Disaggregation of these costs is not necessary to determine the explicit support level.
2. Determine local exchange revenues by LEC by State study area. These revenues per line have been determined to be just, reasonable and affordable and encompass local rates that are comparable in urban and rural areas as required by Sections 254b(1) and b(3) of the Act. Specifically:
  - a) Add the revenue in the following accounts to determine the local revenues:
    - Account 5001-Basic Local
    - Account 5002-Optional EAS
    - Account 5050-Customer Premise
    - Account 5060-Other Local (Primarily Vertical Services)
    - Account 5081-End User Charges
    - Account 5230-Directory
  - b) This information is readily available for every LEC.

3. Calculate the explicit support required for each LEC by State study area by subtracting the local revenues in (2) from the costs in (1). This explicit level would provide specific, predictable and sufficient support as required by Section 254b(5) of the Act.
- a) This support is the revenue now provided implicitly through the following rate elements to support local exchange costs so that universally available local service is available at just, reasonable and affordable rates:
- Intrastate access CCL
  - Intrastate IntraLATA toll loop recovery
  - Interstate access CCL, PICC and customer marketing
  - Interstate LTS
  - Interstate USF
  - Interstate DEM Weighting
- b) The explicit support would be provided to qualifying LECs which deploy Universal Service facilities used to provide (1) their own local service, (2) resale local service, or (3) local service provided via unbundled network elements.
- c) The support requirement could be recalculated on a periodic basis.
- d) USTA provided an analysis of the level of this support to the FCC in 1996, in the Universal Service proceeding. Included with this outline is an updated estimate of this analysis by LEC by State study area.

# 1995 Local Costs, Revenues & Support

Estimated From Publicly Available Data

\$ Millions

| State<br>(a)   | USF Loops<br>(b) | Local Costs<br>(c) | Local Revenues<br>(d) | I-S EUCL<br>(e) | Net Local Revenues<br>(f) = d + e | Local Support Required<br>(g) = c - f |
|----------------|------------------|--------------------|-----------------------|-----------------|-----------------------------------|---------------------------------------|
| Alabama        | 2,273,342        | 1,323.1            | 895.8                 | 105.5           | 1,001.3                           | 321.8                                 |
| Alaska         | 360,287          | 265.9              | 105.0                 | 19.4            | 124.5                             | 141.5                                 |
| Arizona        | 2,413,781        | 1,295.7            | 711.1                 | 117.1           | 828.1                             | 467.6                                 |
| Arkansas       | 1,264,571        | 729.3              | 374.3                 | 61.6            | 435.8                             | 293.4                                 |
| California     | 20,012,652       | 8,920.5            | 5,486.7               | 855.7           | 6,342.4                           | 2,578.0                               |
| Colorado       | 2,380,417        | 1,570.1            | 937.1                 | 118.3           | 1,055.4                           | 514.7                                 |
| Connecticut    | 1,923,443        | 1,291.4            | 810.7                 | 99.5            | 910.2                             | 381.2                                 |
| Delaware       | 486,562          | 210.2              | 123.9                 | 23.5            | 147.4                             | 62.9                                  |
| Florida        | 9,388,137        | 5,276.6            | 3,143.5               | 446.8           | 3,590.3                           | 1,686.3                               |
| Georgia        | 4,248,892        | 2,556.5            | 1,670.6               | 205.6           | 1,876.3                           | 680.2                                 |
| Hawaii         | 674,283          | 467.4              | 279.2                 | 32.4            | 311.6                             | 155.7                                 |
| Idaho          | 614,306          | 342.2              | 146.1                 | 30.2            | 176.2                             | 166.0                                 |
| Illinois       | 7,456,877        | 3,214.6            | 2,456.2               | 316.1           | 2,772.3                           | 442.3                                 |
| Indiana        | 3,220,392        | 1,512.2            | 1,005.9               | 143.9           | 1,149.8                           | 362.5                                 |
| Iowa           | 1,504,188        | 676.4              | 326.8                 | 70.7            | 397.5                             | 278.9                                 |
| Kansas         | 1,462,968        | 794.3              | 400.8                 | 71.3            | 472.1                             | 322.2                                 |
| Kentucky       | 1,937,955        | 1,095.3            | 651.1                 | 90.0            | 741.1                             | 354.2                                 |
| Louisiana      | 2,291,254        | 1,355.4            | 929.1                 | 108.7           | 1,037.8                           | 317.6                                 |
| Maine          | 746,657          | 423.8              | 178.2                 | 35.2            | 213.4                             | 210.5                                 |
| Maryland       | 3,227,987        | 1,638.6            | 1,118.2               | 156.2           | 1,274.4                           | 364.2                                 |
| Massachusetts  | 4,073,588        | 2,200.1            | 1,472.6               | 205.4           | 1,678.0                           | 522.1                                 |
| Michigan       | 5,837,415        | 2,670.5            | 1,520.6               | 270.7           | 1,791.2                           | 879.2                                 |
| Micronesia     | 16,065           | 18.5               | 5.9                   | 0.7             | 6.7                               | 11.9                                  |
| Minnesota      | 2,687,645        | 1,262.5            | 764.2                 | 138.5           | 902.7                             | 359.8                                 |
| Mississippi    | 1,252,661        | 847.5              | 537.2                 | 58.7            | 595.9                             | 251.6                                 |
| Missouri       | 3,059,291        | 1,693.4            | 922.3                 | 146.8           | 1,069.1                           | 624.4                                 |
| Montana        | 475,375          | 291.3              | 106.1                 | 25.7            | 131.8                             | 159.5                                 |
| Nebraska       | 937,590          | 575.2              | 388.9                 | 44.6            | 433.5                             | 141.7                                 |
| Nevada         | 1,028,135        | 404.9              | 263.4                 | 43.5            | 306.8                             | 98.1                                  |
| New Hampshire  | 736,058          | 408.7              | 223.1                 | 38.2            | 261.3                             | 147.4                                 |
| New Jersey     | 5,649,903        | 2,490.4            | 1,319.3               | 265.8           | 1,585.1                           | 905.3                                 |
| New Mexico     | 837,832          | 516.9              | 294.3                 | 41.8            | 336.2                             | 180.7                                 |
| New York       | 11,946,246       | 7,950.7            | 5,344.3               | 672.1           | 6,016.4                           | 1,934.3                               |
| North Carolina | 4,236,644        | 2,363.4            | 1,371.5               | 200.2           | 1,571.6                           | 791.7                                 |
| North Dakota   | 388,202          | 195.3              | 80.5                  | 21.4            | 101.9                             | 93.4                                  |
| Ohio           | 6,231,784        | 3,227.1            | 2,286.8               | 291.8           | 2,578.6                           | 648.5                                 |
| Oklahoma       | 1,789,026        | 957.9              | 530.3                 | 87.2            | 617.5                             | 340.4                                 |
| Oregon         | 1,826,728        | 945.3              | 504.9                 | 124.8           | 629.7                             | 315.6                                 |
| Pennsylvania   | 7,435,104        | 3,339.7            | 1,930.3               | 350.2           | 2,280.5                           | 1,059.2                               |
| Puerto Rico    | 1,136,461        | 1,021.4            | 531.3                 | 55.0            | 586.3                             | 435.2                                 |
| Rhode Island   | 598,945          | 315.9              | 195.7                 | 27.2            | 222.9                             | 93.0                                  |
| South Carolina | 1,946,001        | 1,188.3            | 766.3                 | 94.1            | 860.4                             | 327.9                                 |
| South Dakota   | 390,428          | 196.2              | 89.5                  | 22.1            | 111.6                             | 84.5                                  |
| Tennessee      | 3,051,648        | 1,711.3            | 1,073.9               | 144.5           | 1,218.4                           | 492.9                                 |
| Texas          | 10,564,309       | 6,144.3            | 3,202.9               | 519.0           | 3,721.9                           | 2,422.4                               |
| Utah           | 976,484          | 522.5              | 284.4                 | 48.9            | 333.2                             | 189.2                                 |
| Vermont        | 367,444          | 228.6              | 94.0                  | 17.3            | 111.3                             | 117.3                                 |
| Virgin Islands | 39,999           | 48.5               | 36.2                  | 3.0             | 39.1                              | 9.4                                   |
| Virginia       | 3,998,775        | 2,039.3            | 1,303.5               | 199.4           | 1,502.9                           | 536.4                                 |
| Washington DC  | 883,538          | 463.2              | 364.1                 | 24.1            | 388.2                             | 74.9                                  |
| Washington     | 3,201,468        | 1,751.7            | 887.6                 | 155.9           | 1,043.5                           | 708.1                                 |
| West Virginia  | 905,381          | 575.1              | 322.5                 | 42.7            | 365.3                             | 209.8                                 |
| Wisconsin      | 3,043,132        | 1,297.3            | 840.2                 | 145.3           | 985.5                             | 311.8                                 |
| Wyoming        | 271,667          | 172.2              | 61.4                  | 17.2            | 78.6                              | 93.6                                  |
| Totals         | 159,709,923      | 84,994.5           | 51,670.2              | 7,651.3         | 59,321.5                          | 25,673.0                              |

Note: Column f includes vertical service revenues.

# 1995 Local Costs, Revenues & Support

Estimated From Publicly Available Data

\$ Millions

| State<br>(a)   | USF Loops<br>(b) | Local Costs<br>(c) | Local Revenues<br>(d) | I-S EUCL<br>(e) | Net Local Revenues<br>(f) = d + e | Local Support Required<br>(g) = c - f |
|----------------|------------------|--------------------|-----------------------|-----------------|-----------------------------------|---------------------------------------|
| Alabama        | 2,273,342        | 1,323.1            | 563.4                 | 105.5           | 669.0                             | 654.1                                 |
| Alaska         | 360,287          | 265.9              | 85.9                  | 19.4            | 105.3                             | 160.6                                 |
| Arizona        | 2,413,781        | 1,295.7            | 566.5                 | 117.1           | 683.5                             | 612.1                                 |
| Arkansas       | 1,264,571        | 729.3              | 296.5                 | 61.6            | 358.0                             | 371.3                                 |
| California     | 20,012,652       | 8,920.5            | 4,332.2               | 855.7           | 5,187.9                           | 3,732.5                               |
| Colorado       | 2,380,417        | 1,570.1            | 799.7                 | 118.3           | 918.0                             | 652.1                                 |
| Connecticut    | 1,923,443        | 1,291.4            | 726.3                 | 99.5            | 825.8                             | 465.6                                 |
| Delaware       | 486,562          | 210.2              | 98.0                  | 23.5            | 121.5                             | 88.8                                  |
| Florida        | 9,388,137        | 5,276.6            | 2,405.0               | 446.8           | 2,851.9                           | 2,424.7                               |
| Georgia        | 4,248,892        | 2,556.5            | 1,273.9               | 205.6           | 1,479.5                           | 1,076.9                               |
| Hawaii         | 674,283          | 467.4              | 236.9                 | 32.4            | 269.3                             | 198.1                                 |
| Idaho          | 614,306          | 342.2              | 119.1                 | 30.2            | 149.3                             | 192.9                                 |
| Illinois       | 7,456,877        | 3,214.6            | 2,072.0               | 316.1           | 2,388.0                           | 826.6                                 |
| Indiana        | 3,220,392        | 1,512.2            | 855.3                 | 143.9           | 999.2                             | 513.1                                 |
| Iowa           | 1,504,188        | 676.4              | 265.2                 | 70.7            | 335.9                             | 340.5                                 |
| Kansas         | 1,462,968        | 794.3              | 302.7                 | 71.3            | 374.0                             | 420.3                                 |
| Kentucky       | 1,937,955        | 1,095.3            | 488.9                 | 90.0            | 578.9                             | 516.4                                 |
| Louisiana      | 2,291,254        | 1,355.4            | 446.4                 | 108.7           | 555.1                             | 800.3                                 |
| Maine          | 746,657          | 423.8              | 154.2                 | 35.2            | 189.5                             | 234.4                                 |
| Maryland       | 3,227,987        | 1,638.6            | 909.7                 | 156.2           | 1,066.0                           | 572.7                                 |
| Massachusetts  | 4,073,588        | 2,200.1            | 1,287.0               | 205.4           | 1,492.4                           | 707.7                                 |
| Michigan       | 5,837,415        | 2,670.5            | 1,169.0               | 270.7           | 1,439.7                           | 1,230.8                               |
| Micronesia     | 16,065           | 18.5               | 5.3                   | 0.7             | 6.1                               | 12.5                                  |
| Minnesota      | 2,687,645        | 1,262.5            | 603.8                 | 138.5           | 742.2                             | 520.3                                 |
| Mississippi    | 1,252,661        | 847.5              | 391.0                 | 58.7            | 449.8                             | 397.7                                 |
| Missouri       | 3,059,291        | 1,693.4            | 681.1                 | 146.8           | 827.9                             | 865.5                                 |
| Montana        | 475,375          | 291.3              | 87.9                  | 25.7            | 113.6                             | 177.7                                 |
| Nebraska       | 937,590          | 575.2              | 333.7                 | 44.6            | 378.3                             | 196.9                                 |
| Nevada         | 1,028,135        | 404.9              | 191.9                 | 43.5            | 235.3                             | 169.6                                 |
| New Hampshire  | 736,058          | 408.7              | 196.5                 | 38.2            | 234.7                             | 174.0                                 |
| New Jersey     | 5,649,903        | 2,490.4            | 940.2                 | 265.8           | 1,206.0                           | 1,284.4                               |
| New Mexico     | 837,832          | 516.9              | 243.4                 | 41.8            | 285.3                             | 231.6                                 |
| New York       | 11,946,246       | 7,950.7            | 4,209.6               | 672.1           | 4,881.8                           | 3,068.9                               |
| North Carolina | 4,236,644        | 2,363.4            | 1,093.9               | 200.2           | 1,294.1                           | 1,069.2                               |
| North Dakota   | 388,202          | 195.3              | 66.6                  | 21.4            | 88.1                              | 107.2                                 |
| Ohio           | 6,231,784        | 3,227.1            | 1,898.4               | 291.8           | 2,190.2                           | 1,036.8                               |
| Oklahoma       | 1,789,026        | 957.9              | 402.9                 | 87.2            | 490.1                             | 467.8                                 |
| Oregon         | 1,826,728        | 945.3              | 400.3                 | 124.8           | 525.1                             | 420.2                                 |
| Pennsylvania   | 7,435,104        | 3,339.7            | 1,490.4               | 350.2           | 1,840.6                           | 1,499.1                               |
| Puerto Rico    | 1,136,461        | 1,021.4            | 492.0                 | 55.0            | 547.0                             | 474.4                                 |
| Rhode Island   | 598,945          | 315.9              | 175.6                 | 27.2            | 202.8                             | 113.1                                 |
| South Carolina | 1,946,001        | 1,188.3            | 578.5                 | 94.1            | 672.6                             | 515.7                                 |
| South Dakota   | 390,428          | 196.2              | 70.7                  | 22.1            | 92.8                              | 103.4                                 |
| Tennessee      | 3,051,648        | 1,711.3            | 731.6                 | 144.5           | 876.0                             | 835.2                                 |
| Texas          | 10,564,309       | 6,144.3            | 2,459.7               | 519.0           | 2,978.7                           | 3,165.6                               |
| Utah           | 976,484          | 522.5              | 226.1                 | 48.9            | 275.0                             | 247.5                                 |
| Vermont        | 367,444          | 228.6              | 101.1                 | 17.3            | 118.4                             | 110.2                                 |
| Virgin Islands | 39,999           | 48.5               | 31.7                  | 3.0             | 34.7                              | 13.8                                  |
| Virginia       | 3,998,775        | 2,039.3            | 1,083.0               | 199.4           | 1,282.4                           | 756.9                                 |
| Washington DC  | 883,538          | 463.2              | 294.3                 | 24.1            | 318.3                             | 144.8                                 |
| Washington     | 3,201,468        | 1,751.7            | 717.1                 | 155.9           | 873.0                             | 878.6                                 |
| West Virginia  | 905,381          | 575.1              | 276.6                 | 42.7            | 319.3                             | 255.8                                 |
| Wisconsin      | 3,043,132        | 1,297.3            | 721.7                 | 145.3           | 867.0                             | 430.3                                 |
| Wyoming        | 271,667          | 172.2              | 50.3                  | 17.2            | 67.5                              | 104.7                                 |
| Totals         | 159,709,923      | 84,994.5           | 40,701.0              | 7,651.3         | 48,352.3                          | 36,642.2                              |

Note: Column f does not include vertical service revenues.

## **Costs of Universal Service**

1. After more than two years of development, with no end in sight:
  - Do Proxy Models accurately produce the costs of universal service?
  - Are the models simply being manipulated to achieve a desired cost/support result?
  - Will this result in sufficient and predictable support as required by the Federal Act?
2. Perhaps we have lost sight of the objective:
  - What does it really cost to build a network capable of (a) serving all who want service (COLR) and (b) providing "quality" universal service which is "comparable" in urban and rural areas?

# WHICH HYPOTHETICAL PROXY COST REFLECTS THE "TRUE" FORWARD-LOOKING ECONOMIC COST OF UNIVERSAL SERVICE?

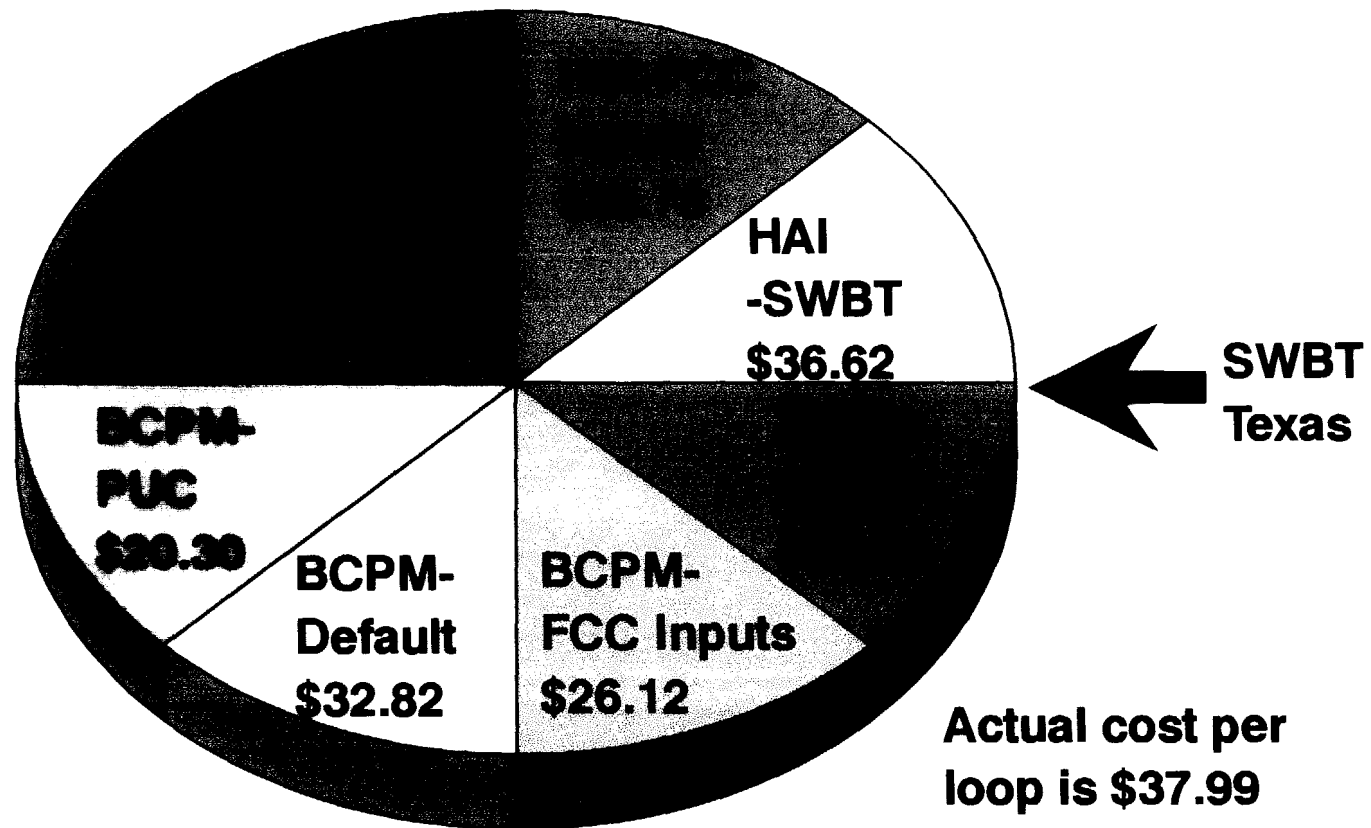
| <u>MODEL DESCRIPTION</u>   | <u>AVERAGE COST PER LOOP</u>  |           |           |           |           |
|--|---|-----------|-----------|-----------|-----------|
|  | Hatfield/HAI - Sum of Unbundled elements for SWBT;<br>BCM/BCPM - Total average cost of Universal Service for entire state |           |           |           |           |
|  | <b>AR</b>   | <b>KS</b> | <b>MO</b> | <b>OK</b> | <b>TX</b> |
| Hatfield, Version 2.2, Release 1, 5/16/96  | \$23.41   |           | \$20.51   | \$21.17   | \$16.96   |
| Hatfield, Version 2.2, Release 2, 9/4/96   | \$22.20   | \$21.02   | \$18.74   | \$21.32   | \$16.76   |
| Hatfield, Version 3.1, 2/28/97   | \$23.33   | \$19.77   | \$17.80   | \$21.76   | \$16.98   |
| Hatfield, Version 4.0, 8/5/97  | \$24.19   | \$20.77   | \$17.71   | \$23.04   | \$16.74   |
| Hatfield, Version 5.0, 12/15/97  | \$22.67   | \$20.99   | \$17.59   | \$22.20   | \$16.27   |
| Hatfield - HAI, Version 5.0a, Default Inputs,<br>(NOTE #1)                           | \$22.58   | \$20.73   | \$18.76   | \$22.27   | \$16.67   |
| Hatfield - HAI, Version 5.0a FCC Inputs<br>(NOTE #1)                                 | \$28.34   | \$26.45   | \$25.02   | \$28.73   | \$22.78   |
|  |   |           |           |           |           |
| BCM or BCPM Benchmark Cost Model, Version 1,<br>MCI, NYNEX, SPRINT, US West, 12/1/95 | \$33.56   | \$33.01   | \$28.43   | \$26.59   | \$24.14   |
| BCM2, SPRINT, US West, 7/3/96  | \$40.97   | \$35.37   | \$34.17   | \$35.06   | \$29.98   |
| Benchmark Cost Proxy Model (BCPM), SPRINT,<br>US West, Pacific Bell, 1/31/97         | \$52.97   | \$44.55   | \$41.05   | \$44.65   | \$36.30   |
| BCPM, SPRINT Only Inputs, 3/24/97  |   |           |           |           |           |
| BCPM 3.0 Default Inputs, 2/5/98  |   |           |           |           |           |
| BCPM 3.0 FCC Inputs, 2/5/98  |   |           |           |           |           |
| BCPM 3.x, Default Inputs (NOTE #1)   | \$45.66   | \$40.69   | \$34.32   | \$41.34   | \$32.82   |
| BCPM 3.x, FCC Inputs, (NOTE #1)  | \$34.48   | \$31.28   | \$27.07   | \$31.47   | \$26.12   |

NOTE #1 These numbers were taken from an Ex Parte letter to the FCC in CC Docket No. 96-45 & 97-160 by MCI, dated April 17, 1998. The same numbers were included in an Ex Parte filed by AT&T on April 3, 1998 in CC Docket No., 96-45 & 97-160 on April 10, 1998.



# The Forward-looking Economic Cost Model

## WHEEL of FORTUNE



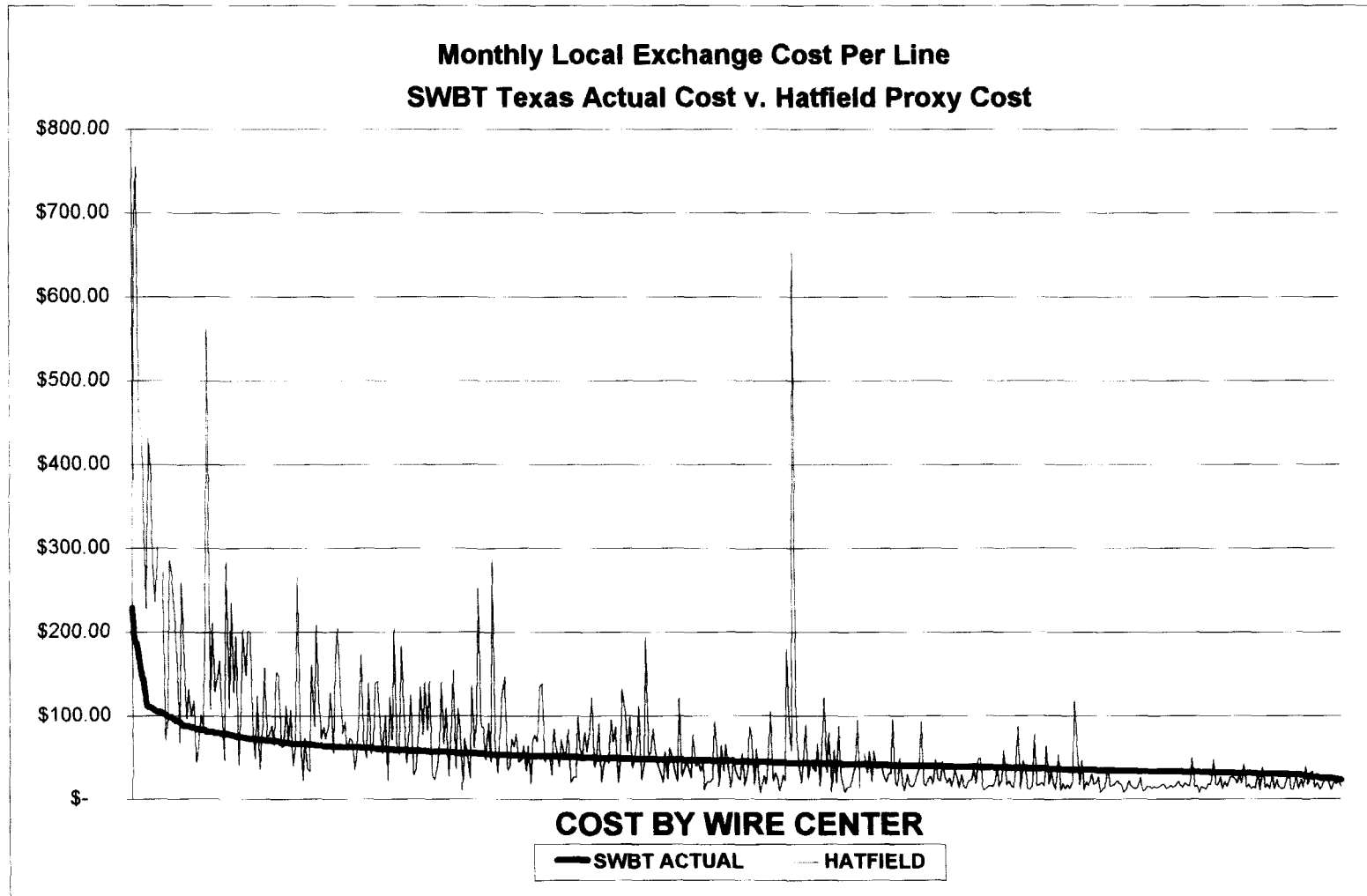
It Appears that Proxy Models:

1. Can't determine an accurate cost of Universal Service, but
2. May be inappropriately utilized to achieve a desired support level by manipulating inputs or logic.

### Hatfield Proxy Model



Does not accurately reflect actual wire center costs of universal service.  
Skews costs to the rural areas.



## BCPM Proxy Model



Does not accurately reflect actual wire center costs of universal service.

